Singapore Company Guide

Manulife US Real Estate Inv

Version 14 | Bloomberg: MUST SP | Reuters: MANU.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Aug 2019

BUY

Last Traded Price (22 Aug 2019): US$0.895 (**STI :** 3,127.74)
Price Target 12-mth: US$1.10 (23% upside) (Prev US$1.00)

Analyst
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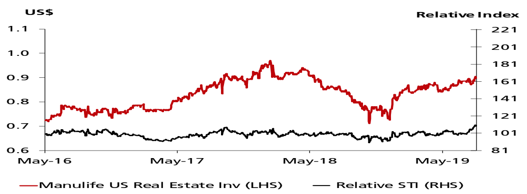
What's New

- Poised to deliver a strong 3-year DPU CAGR of 4.5%, fastest amongst peers
- Portfolio to benefit from strong market dynamics with positive leasing spreads to result in higher earnings
- Potential index inclusion a catalyst for the stock
- Pricing in acquisitions in our estimates

Price Relative



Forecasts and Valuation

FY Dec (US$m)	2018A	2019F	2020F	2021F
Gross Revenue	145	170	192	207
Net Property Inc	90.7	108	122	133
Total Return	64.5	72.0	83.2	90.3
Distribution Inc	71.0	81.4	94.1	101
EPU (US cts.)	5.06	5.35	5.54	5.64
EPU Gth (%)	(10)	6	4	2
DPU (US cts.)	5.57	6.05	6.27	6.32
DPU Gth (%)	2	9	4	1
NAV per shr (US cts.)	83.4	86.1	86.5	81.1
PE (X)	17.7	16.7	16.1	15.9
Distribution Yield (%)	6.2	6.8	7.0	7.1
P/NAV (x)	1.1	1.0	1.0	1.1
Aggregate Leverage (%)	37.2	37.1	36.7	37.1
ROAE (%)	6.7	6.5	6.8	7.0
Distn. Inc Chng (%):		(3)	5	11
Consensus DPU (US cts.):		5.9	6.1	6.2
Other Broker Recs:		B: 6	S: 0	H: 0

Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

Poised to join the big boys

Poised to move higher. We maintain our BUY call on Manulife US Real Estate Investment Trust (MUST) with a revised TP of US$1.10. With tax concerns largely allayed in our view, we believe that investors will look towards MUST's consistent delivery of a 4.5% CAGR in FY19-21F DPU to drive higher valuations for the stock. Supported by conducive cost of capital, we see MUST soaring to greater heights. BUY with a TP of S$1.10.

Where we differ: Pricing in acquisitions in our forecasts. On the back of the recent completion of Fairfax Center, we believe that MUST remains poised to continue acquiring as the manager looks to deliver on both organic and inorganic growth. We believe MUST will continue to offer investors compelling value as its DPU remains on an uptrend given its (i) ability to surprise on accretive acquisitions, and (ii) positive leasing spreads to drive earnings and NAV higher. Moreover, MUST's forward yield of 7.0% stands at c.150bps higher than the S-REIT average but offers a superior 3-year DPU CAGR of c.4.5%.

Indexation a catalyst for the stock. We believe that MUST is on the cusp of being considered for inclusion into the FTSE EPRA Nareit Developed Asia Index and is noted to be c.US$130-US$140m away. We have priced in an accretive acquisition of US$200m (funded by 70% equity) which, in our view, will likely pave the way for the REIT's potential index inclusion. This will likely herald a virtuous cycle of greater investor visibility, trading liquidity and over time, yield compression of the stock.

Valuation:

We have revised up our DCF-backed TP to US$1.10 on the back of acquisition and lower WACC assumptions.

Key Risks to Our View:

The key risk to our view is lower occupancy and/or slower-than-expected recovery of office rentals in the US, as well as impact from changes in tax laws resulting in higher taxes paid.

At A Glance

Issued Capital (m shrs)	1,398
Mkt. Cap (US$m)	1,251
Major Shareholders (%)	
Manulife Financial Corp	6.4
Prudential Plc	5.5
Free Float (%)	88.1
3m Avg. Daily Val (US$m)	1.6

ICB Industry : Real Estate / Real Estate Investment Trust

DBS
Live more, Bank less

WHAT'S NEW

Moving up to the big leagues

Robust NPI growth of 33.8% y-o-y in 2Q19 concluded a healthy first half

- Manulife US REIT (MUST) reported a strong set of results. In 2Q19, total revenue and net property income (NPI) increased by 33.2% and 33.8% y-o-y to US$43.3m and US$27.4m respectively. This increase was attributable to additional income arising from the new contributions of Centerpointe (1Q19), Penn and Phipps buildings which were acquired back in June 2018. Excluding the impact of the three acquisitions, underlying NPI dipped 2.5% y-o-y in 2Q19, mainly due to the 4.3% y-o-y drop in NPI for Plaza and 2.0% y-o-y drop in Michelson. This was largely due to lower rents for renewals. Distributable income came in 25% higher y-o-y but DPU rose by 17.7% to 1.53 Scts. After adjusting the impact of the rights issue a year ago, DPU would have come in flat y-o-y. On a 1H19 basis, DPU of 3.04 Scts formed 50% of our full-year forecasts.

- MUST also has a well-diversified tenant base with its largest tenant contributing not more than 6.7% of its total rental income in 1H19. Overall portfolio occupancy improved to 97.2% in 2Q19 from 96.0% in 2Q18 and 97.4% at end-1Q19 due to a robust leasing momentum as high-quality tenants signed long leases in 1H19.

- **Portfolio occupancy rates improved q-o-q.** Overall portfolio occupancy rates remained stable at c.97.2% (-0.2bps q-o-q). We note that most of the properties maintained above-market occupancy rates, owing to their "best-in-class" property attributes. Amongst the properties, we note a slight dip in occupancy rates for the Exchange (95.8% vs 97.7% a quarter ago) while other properties continue to maintain high occupancy rates of >93%.

- **Positive leasing momentum**. Weighted average lease expiry (WALE) improved from 6.0 years to 6.2 years. MUST renewed 367k sqft of leases in 1H19 with an average positive rental reversion of +0.3%, due to the "marking of market" of Michelson's leases. A bulk of the renewals came from the Michelson (c.41% of NLA) where two anchors renewed for another substantial 11-year term, a positive in our view as it reduces leasing risk for the property. Escalations of 3% per annum for the two leases ensure a steady rate of growth over time.

- **Improved gearing; minimal refinancing needs in 2H19.** MUST's gearing dropped to 37.1% (1Q19: 37.6%) with average cost of debt at 3.32%. During the quarter, MUST refinanced US$117m of the Figuero Loan by securing US$193m 5-year committed Trust level credit facilities with a Singapore-based bank. The remainder of the facility consists of Centerpointe acquisition term loan of US$33m and revolving credit facility of US$50m. The refinancing improved average debt maturity to 3.1 years compared to 2.3 years as at 30 June 2019. As at end-2Q19, the proportion of fixed rate debt had dropped to 96.1% (1Q19: 98.2%) with NAV per unit at US$0.79.

Forward outlook

- **Positive leasing spreads underpin a steady organic growth profile.** With less than 1% of NLA up for renewal in 2H19, income is fairly secured with a focus on the forward renewals of c.7.3% of NLA (c.7.7% of gross rental income) in FY20. We anticipate strong rental reversionary trends driven mainly by positive leasing spreads across its portfolio where the majority of its properties in-place rents are below market transaction levels.
- **Indexation a catalyst for a further re-rating.** The manager noted that the REIT is c.US$130-140m away from the minimum threshold for consideration for inclusion in the FTSE EPRA Nareit Developed Asia Index. The manager believes that in the longer term, this inclusion will bring about more liquidity, international visibility and potentially a further rally in share price.
- **Acquisitions**. The manager remains on the hunt for more assets and we believe given the deep pool of available assets in the US, supported by a strong sponsor presence, acquisitions will be a main driver of growth for MUST. We have priced in a further US$200m acquisition (70% or US$140m of equity raised) in our estimates for FY20. With this acquisition, MUST would offer investors an attractive FY19-21F DPU of 4.5%.

Quarterly / Interim Income Statement (US$m)

FY Dec	2Q2018	1Q2019	2Q2019	% chg yoy	% chg qoq
Gross revenue	32.5	40.0	43.3	33.2	8.2
Property expenses	(12.1)	(14.9)	(16.1)	32.2	7.5
Net Property Income	20.4	25.1	27.3	33.8	8.7
Other Operating expenses	(2.3)	(2.6)	(2.9)	24.8	13.3
Other Non Opg (Exp)/Inc	0.0	0.0	(0.9)	nm	nm
Net Interest (Exp)/Inc	(3.7)	(5.8)	(6.1)	(62.6)	(5.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	**14.3**	**16.8**	**17.3**	**21.2**	**3.5**
Tax	(6.1)	(2.6)	0.07	(101.1)	(102.6)
Minority Interest	0.0	0.0	0.0	-	-
Net Income after Tax	**8.22**	**14.1**	**17.4**	**111.6**	**23.1**
Total Return	19.0	13.7	2.92	(84.6)	(78.7)
Non-tax deductible Items	(2.5)	5.62	17.7	nm	215.1
Net Inc available for Dist.	16.5	19.3	20.6	25.0	6.6
Ratio (%)					
Net Prop Inc Margin	62.7	62.7	62.9		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Upturn in US real estate. Based on CoStar data, MUST's properties are generally located in the US office markets where there is limited new supply. For markets with new supply, we understand the majority of the new supply is already pre-committed or due to the high development costs, requires significantly higher asking rents than MUST's buildings. In addition, we understand these office markets also have favourable demand dynamics in the form of rising demand on the back of increasing business activities and low unemployment rates. In addition, MUST's properties are generally located in markets where there is a deep pool of skilled and young workers, which is an attractive feature for prospective tenants. Furthermore, the buildings are situated near amenities, which add to the competitive position of MUST's portfolio. Given the supportive market dynamics, market rents in MUST's key markets are generally on an upturn. Therefore, we believe MUST offers a cyclical recovery story, with rising income and potential for some uplift in capital values.

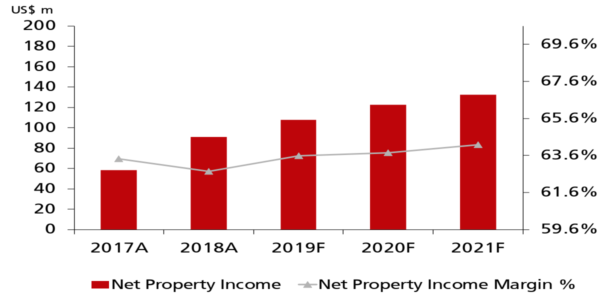
Organic growth. MUST's properties are well positioned to experience strong organic growth delivered through inbuilt rental escalations embedded into their lease contracts. Approximately 55% of leases (by NLA) for MUST's portfolio have inbuilt annual rental escalations of around 2.5%, with c.39% of leases (by NLA) with mid-term or period rent increases, thus providing a visible and growing income stream.

WALE offers strong income. With leases typically signed on a 3- to 10-year lease and some in excess of 10 years, MUST's portfolio enjoys a long WALE of c.6.2 years (by NLA). Some 7.7% of its leases (by gross rental income) are expiring in 2019 and 2020 respectively. We expect these leases to revert positively when they are due for renewal as the majority of MUST's buildings are 5-10% below market rents.

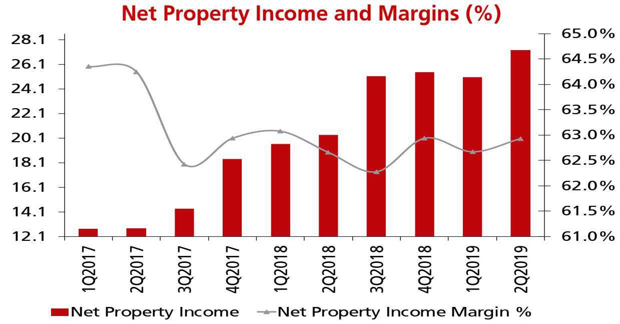
Boost from recent acquisitions. In FY19, we expect MUST's DPU to be boosted by the full-year contribution from the recent acquisitions of 1750 Pennsylvania Avenue, Washington DC, Phipps Tower, Atlanta and Centerpointe I & II, Virginia. Beyond providing additional geographical diversification, these acquisitions should assist MUST in delivering c.4% DPU CAGR over FY19-21F, making it one of the fastest-growing REITs listed in Singapore over the next three years.

Growth through acquisitions. A key growth driver is MUST's ability to leverage on its sponsor's deep knowledge of the US office market and execution capability.

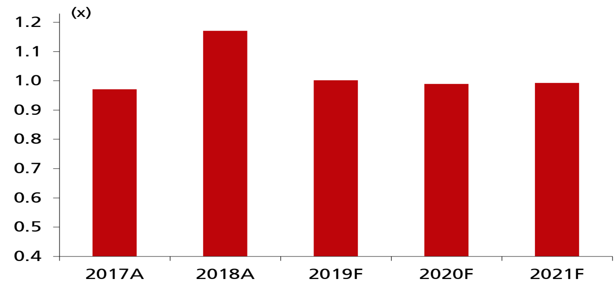
Net Property Income and Margins (%)



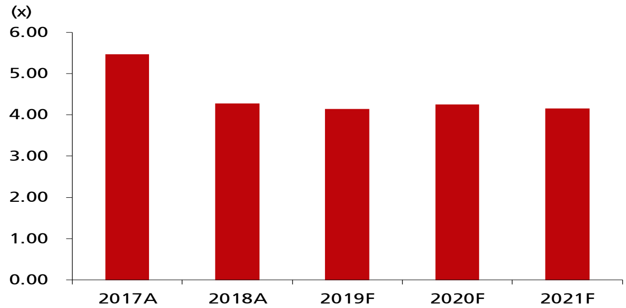
Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Interest Cover (x)



Source: Company, DBS Bank

Balance Sheet:

Gearing stabilising at around 37-38%. Post recent acquisitions and equity-raising, MUST's gearing (total debt/total assets) has stabilised at around 37-38%. This provides additional debt headroom for MUST when it explores acquisition opportunities.

Share Price Drivers:

Indexation a catalyst for a further re-rating. The manager noted that the REIT is c.US$130-140m away from the minimum threshold for consideration for inclusion in the FTSE EPRA Nareit Developed Asia Index. The manager believes that in the longer term, this inclusion will bring about more liquidity, international visibility and potentially a further rally in share price.

Key Risks:

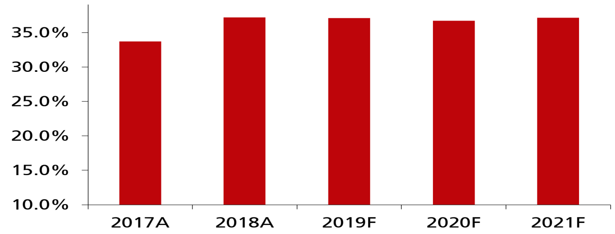
Non-renewal of leases. MUST's financials, operations and capital growth may be adversely affected by bankruptcy, insolvency or downturn in the businesses of its tenants, which may lead to non-renewal of their leases.

Regulatory changes. MUST's tax efficiency relies in part on its parent US REIT and sub-US REITs being able to maintain their status as US REITs, as well as qualifying for US portfolio interest exemption when repatriating cashflows back to Singapore as interest. Distributions paid to MUST's unitholders may be adversely impacted should there be any changes in tax or REIT regulations, in either the US, Singapore or Barbados. In particular, we are awaiting clarification on the efficacy of repatriating cash back to Singapore via Barbados entities.

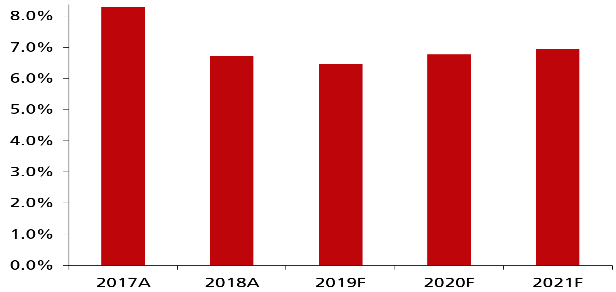
Company Background

Manulife US REIT (MUST) is the first pure-play US office REIT listed in Asia. Its portfolio consists of eight freehold, Class A or Trophy quality office properties in Atlanta, Los Angeles, New Jersey, Washington DC, Virginia and Orange County.

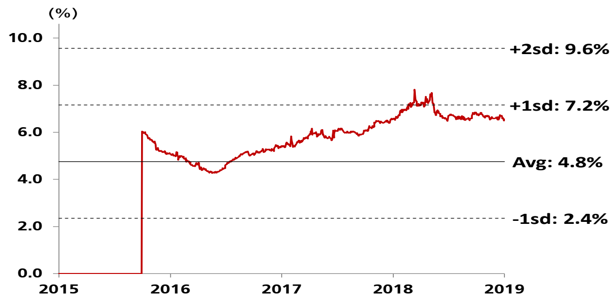
Aggregate Leverage (%)



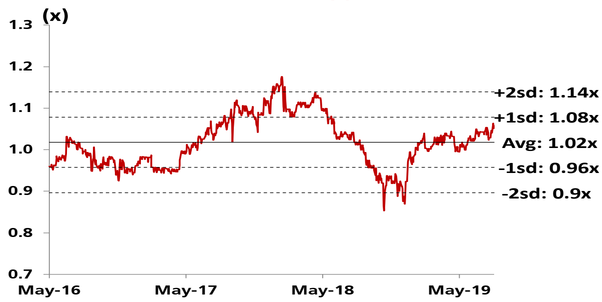
ROE (%)



Distribution Yield (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (US$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Gross revenue	92.0	145	170	192	207
Property expenses	(33.7)	(53.9)	(61.8)	(69.6)	(74.0)
Net Property Income	58.4	90.7	108	122	133
Other Operating expenses	(6.5)	(9.3)	(12.0)	(12.4)	(12.5)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(9.5)	(19.0)	(23.1)	(25.9)	(28.9)
Exceptional Gain/(Loss)	31.4	16.9	0.0	0.0	0.0
Net Income	73.8	79.2	72.7	84.0	91.2
Tax	(15.8)	(14.7)	(0.7)	(0.8)	(0.9)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	58.0	64.5	72.0	83.2	90.3
Total Return	58.0	64.5	72.0	83.2	90.3
Non-tax deductible Items	(11.2)	6.46	9.42	10.9	10.8
Net Inc available for Dist.	46.7	71.0	81.4	94.1	101
Growth & Ratio					
Revenue Gth (%)	93.7	57.1	17.4	13.1	7.7
N Property Inc Gth (%)	94.7	55.4	19.0	13.4	8.4
Net Inc Gth (%)	12.2	11.3	11.5	15.6	8.5
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	63.4	62.7	63.6	63.7	64.2
Net Income Margins (%)	63.0	44.6	42.4	43.3	43.7
Dist to revenue (%)	50.8	49.1	48.0	49.0	48.9
Managers & Trustee's fees	7.0	6.5	7.1	6.5	6.1
ROAE (%)	8.3	6.7	6.5	6.8	7.0
ROA (%)	5.2	4.1	3.8	4.0	4.2
ROCE (%)	4.0	4.5	5.4	5.6	5.8
Int. Cover (x)	5.5	4.3	4.1	4.2	4.2

Source: Company, DBS Bank

Acquisitions assumed in our forecasts by middle of 2020

Quarterly / Interim Income Statement (US$m)

FY Dec	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Gross revenue	32.5	40.4	40.5	40.0	43.3
Property expenses	(12.1)	(15.2)	(15.0)	(14.9)	(16.1)
Net Property Income	20.4	25.1	25.5	25.1	27.3
Other Operating expenses	(2.3)	(2.5)	(2.4)	(2.6)	(2.9)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	(0.9)
Net Interest (Exp)/Inc	(3.7)	(5.8)	(5.8)	(5.8)	(6.1)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	**14.3**	**16.9**	**17.3**	**16.8**	**17.3**
Tax	(6.1)	(2.5)	(4.8)	(2.6)	0.07
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Income after Tax	**8.22**	**14.4**	**12.5**	**14.1**	**17.4**
Total Return	19.0	13.5	20.5	13.7	2.92
Non-tax deductible Items	(2.5)	5.79	(0.9)	5.62	17.7
Net Inc available for Dist.	16.5	19.3	19.6	19.3	20.6
Growth & Ratio					
Revenue Gth (%)	4	24	0	(1)	8
N Property Inc Gth (%)	4	23	1	(2)	9
Net Inc Gth (%)	(34)	75	(13)	13	23
Net Prop Inc Margin (%)	62.7	62.3	62.9	62.7	62.9
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

Balance Sheet (US$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Investment Properties	1,313	1,739	1,892	2,106	2,123
Other LT Assets	0.0	0.0	0.0	0.0	0.0
Cash & ST Invts	49.7	54.1	47.2	46.3	44.9
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	5.91	9.07	10.3	11.6	12.5
Other Current Assets	0.82	1.00	1.00	1.00	1.00
Total Assets	**1,369**	**1,803**	**1,951**	**2,165**	**2,181**
ST Debt	0.0	110	110	110	110
Creditor	18.2	16.8	17.9	20.2	21.8
Other Current Liab	0.99	2.15	2.15	2.15	2.15
LT Debt	458	557	610	682	697
Other LT Liabilities	39.5	52.6	52.6	52.6	52.6
Unit holders' funds	852	1,064	1,158	1,298	1,298
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Funds & Liabilities	**1,369**	**1,803**	**1,951**	**2,165**	**2,181**
Non-Cash Wkg. Capital	(12.5)	(8.9)	(8.7)	(9.7)	(10.4)
Net Cash/(Debt)	(409)	(613)	(673)	(745)	(762)
Ratio					
Current Ratio (x)	2.9	0.5	0.5	0.4	0.4
Quick Ratio (x)	2.9	0.5	0.5	0.4	0.4
Aggregate Leverage (%)	33.7	37.2	37.1	36.7	37.1
Z-Score (X)	1.2	1.1	1.2	1.2	1.2

Source: Company, DBS Bank

Gearing remains stable at c.37%

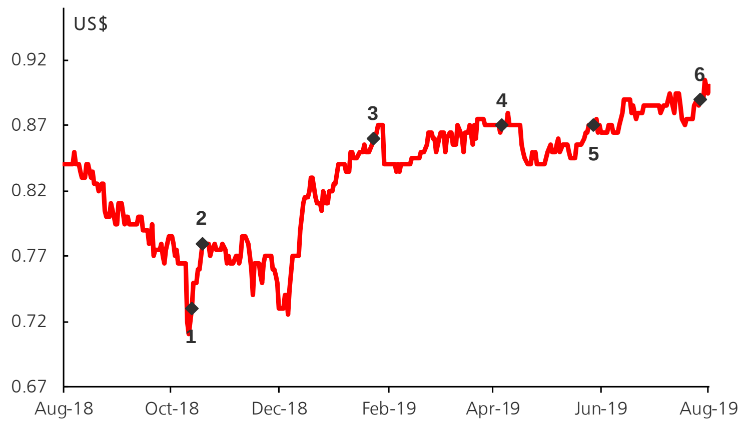
Cash Flow Statement (US$m)

FY Dec	2017A	2018A	2019F	2020F	2021F
Pre-Tax Income	42.4	62.3	72.7	84.0	91.2
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(1.0)	(0.3)	(0.7)	(0.8)	(0.9)
Associates &JV Inc/(Loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	4.26	(3.6)	(0.2)	0.99	0.66
Other Operating CF	(1.9)	(8.3)	9.42	10.9	10.8
Net Operating CF	**43.8**	**50.1**	**81.2**	**95.1**	**102**
Net Invt in Properties	(434)	(399)	(144)	(202)	(2.1)
Other Invts (net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc. & JVs	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.01	0.21	(10.0)	(11.5)	(14.9)
Net Investing CF	**(434)**	**(399)**	**(154)**	**(213)**	**(16.9)**
Distribution Paid	(42.5)	(58.7)	(81.4)	(94.1)	(101)
Chg in Gross Debt	164	208	53.0	71.5	14.9
New units issued	280	193	94.0	140	0.0
Other Financing CF	0.16	(0.7)	0.0	0.0	0.0
Net Financing CF	**402**	**341**	**65.6**	**117**	**(86.2)**
Currency Adjustments	0.07	0.0	0.0	0.0	0.0
Chg in Cash	11.2	(8.1)	(6.9)	(0.9)	(1.4)
Operating CFPS (US cts.)	3.82	4.21	6.05	6.27	6.32
Free CFPS (US cts.)	(37.8)	(27.4)	(4.6)	(7.1)	6.23

Fund-raising assumed in our estimates

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	01 Nov 18	0.73	0.97	BUY
2:	07 Nov 18	0.78	0.88	BUY
3:	12 Feb 19	0.86	0.92	BUY
4:	26 Apr 19	0.87	0.92	BUY
5:	17 Jun 19	0.87	1.00	BUY
6:	16 Aug 19	0.89	1.00	BUY

***Note**: Share price and Target price are adjusted for corporate actions.*

Source: DBS Bank

Analyst: Derek TAN
Rachel TAN

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 22 Aug 2019 19:24:42 (SGT)
Dissemination Date: 22 Aug 2019 19:40:10 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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